SAUDI ARABIA
Economic Trends

Prepared by the
Embassy of the United States of America
Riyadh, Saudi Arabia

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Saudi Arabia: Key Economic Data (1999 – 2004)

(Current US$ billions unless otherwise noted)

	1999	2000	2001	2002	2003 E	2004 P
Gross Domestic Product	161.0	188.4	183.0	188.2	211.2	*212.8*
Nominal GDP Growth (percent)	10.3	17.1	(2.9)	2.8	12.2	*0.7*
Real GDP Growth (percent)	(0.7)	4.9	1.3	1.0	6.4	*0.5*
Per Capita Nominal GDP (US$)	8,001	9,039	8,482	8,429	9,139	*8,894*
Population (millions)	20.1	20.8	21.6	22.3	23.1	*23.9*
Current Account	0.4	14.3	9.4	11.9	25.0	*10.0*
as a percent of GDP	*0.3*	*7.6*	*5.1*	*6.3*	*11.8*	*4.7*
Average Saudi Oil Price (US$/barrel)	16.7	27.0	22.7	22.8	26.8	*27.8*
Official Foreign Assets Managed by SAMA	37.8	47.5	48.4	41.9	59.5	*65.0*
of which foreign exchange reserves	*17.0*	*19.6*	*17.6*	*20.6*	*22.6*	*25.0*
Foreign Assets						
Saudi Pension Funds (AGI's)	*30.4*	*32.8*	*34.1*	*35.8*	*35.0*	*35.5*
Held by Commercial Banks	10.8	9.8	10.6	14.0	10.9	*9.5*
Exchange Rate (SR/US$)	3.75	3.75	3.75	3.75	3.75	*3.75*
Government Budget Balance	(9.9)	6.1	(7.2)	(5.6)	12.0	*1.8*
Revenues	39.2	68.8	60.8	56.8	78.7	*72.3*
Expenditures	49.1	62.7	68.0	62.4	66.7	*70.5*
balance as a percent of GDP	*(6.1)*	*3.3*	*(3.9)*	*(3.0)*	*5.7*	*0.8*
Central Government Domestic Debt	166.6	164.3	171.5	182.7	168.0	*166.0*
as a percent of GDP	*103.5*	*87.2*	*93.7*	*97.1*	*79.5*	*78.0*
Money Supply Growth (M3, %)	6.8	4.5	5.0	15.2	8.2	*7.0*
Cost of Living (percentage change)	(1.2)	(1.1)	(1.1)	0.2	0.4	*1.0*
All Share Index (TASI), yearly close	2028.5	2258.3	2430.1	2518.1	4437.6	*5100.0*

Note: In 2002, the Central Department of Statistics revised its GDP calculations; as a result, 1996-2001 GDP figures increased substantially.

E – estimate

P - projection

This report can be downloaded from the U.S. Embassy website: http://usembassy.state.gov/riyadh.

- EXECUTIVE SUMMARY –

In spite of the war in Iraq, domestic terrorist attacks and a volatile oil market, the Saudi economy turned in its best performance in 20 years in 2003. Record oil profits fueled a 6.4% real increase in GDP and the second budget surplus in two decades. High oil production volumes were maintained throughout the first two quarters of 2003 and crude prices stayed in the upper end of the $22-28 OPEC band throughout the year. Prosperity from the oil sector washed through the Saudi economy and showed up as hefty profits for oil-related parastatal firms and commercial banks, and sizeable growth in the Saudi stock market. If oil prices remain high, 2004 will be another banner year for the Saudi economy and the national budget could well close in surplus again. In 2003, Saudi Arabia also made significant progress on the economic reform front. The government moved closer to WTO membership, completed the first state asset sell-off, and passed capital market, insurance, anti-money laundering, and IPR protection legislation.

THE ECONOMY:

- Saudi Arabia's economy is overly dependent on oil and oil derivatives, which account for 90-95% of export earnings, 75% of budget revenues and about 35-40% of GDP.
- Saudi Arabia's high population growth (3.3-3.5%) continues to outpace GDP growth. 70% of the population is under 30. The economy is not creating enough jobs to employ all of the estimated 150,000 Saudi entrants into the labor market each year.
- In 2003, GDP per capita rose to over $9,000 for the first time since 2000. Having peaked in 1981 at $28,600 per capita, GDP has been steadily decreasing. Per capita GDP will continue to stagnate unless economic growth increases significantly and/or the birthrate declines.
- Saudi Arabia made substantial progress towards accession to the WTO in 2003 and the outlook for membership in 2004 is promising. WTO membership will bolster reform by increasing competition, transparency and diversification.

BUDGET:

- The government used the 2003 budget surplus to build up foreign exchange reserves and pay down domestic debt, lowering domestic debt to 80% of GDP.
- If oil prices stay high in 2004, government revenues should be enough to cover projected spending. Any deficit will be financed domestically.

ENERGY:

- Saudi Arabia has over 260 billion barrels of proven oil reserves, more than 25% of the world total, and up to 1 trillion barrels of ultimately recoverable oil.
- At its March 2004 meeting, OPEC ministers brought production quota reductions into effect, which suggests OPEC is prepared to defend a price above the official $22-28 per barrel OPEC band.
- Although the Crown Prince's Gas Initiative did not materialize as expected, the upstream natural gas exploration deals signed in 2003 and 2004 mark the first time that foreign oil companies have been permitted to explore in Saudi Arabia since the nationalization of ARAMCO.

CURRENT ACCOUNT AND FINANCE:

- Overseas Saudi private capital remains significant, estimated at between $650–700 billion or more than three times GDP.
- Foreign worker remittances, approximately $16 billion per year, will continue to be a drain on the current account unless the Saudi authorities allow and encourage investment of these funds in the Kingdom.
- The Saudi Riyal will remain pegged to the U.S. dollar. A weak U.S. dollar in 2004 will raise the country's import bill and introduce some inflationary pressure from consumption of Euro-priced goods.

- THE SAUDI ECONOMY -

Macroeconomic Overview

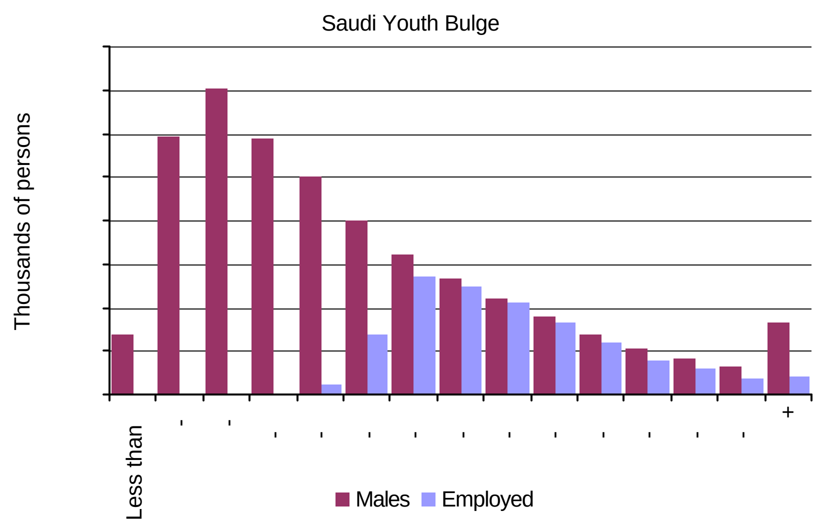
In 2003, the Saudi economy turned in its best performance in 20 years. Record oil revenues and solid private non-oil sector performance combined to create a 12.2% nominal GDP increase (up 6.4% in real terms). Average prices for Saudi crude blends stayed in the upper end of the $22-28 per barrel price band throughout the year and production levels in excess of 9 billion bpd through the first half of 2003 generated a 22% increase in nominal oil sector GDP. The non-oil private sector saw continued growth finishing the year with a 6.5% nominal increase while the government sector grew 5% in nominal terms. Government revenues increased by 39% to $79 billion, while spending increased 7% (20% over budgeted amounts) to $67 billion. Despite significant overspending, the government closed the year with a surplus of over $12 billion, the second surplus in 20 years, some of which was used to reduce government debt and build foreign exchange reserves. The current account surplus doubled to $25 billion. Flush with liquidity from oil earnings, the banking sector enjoyed a profitable year. The stock market rose for the fifth year in a row, doubling overall capitalization in 2003.

The Saudi economy is overly reliant on oil revenue and subject to sharp swings caused by volatile oil prices. Oil and oil derivatives account for 90-95% of export earnings, 75% of budget revenues and about 35-40% of GDP. Over the past five years, GDP has grown in real terms on average only 2.6%, well below the rate of population growth and too slowly to create enough jobs for all of the 150,000 Saudis entering the work force each year. Although the non-oil sector has performed well, averaging slightly over 4% annual growth, together the government and private sector are absorbing only about half the job seekers entering the market each year. The government no longer has the resources to act as employer of last resort or provide the funding needed for basic infrastructure expansion. Some analysts estimate that $250 billion in investment is needed for power generation, telecommunications, desalination, water pipelines and transport links over the next 20 years. The government is looking to the private sector to fund infrastructure investment and create jobs for a rapidly growing population.

Under the Crown Prince's leadership, the government is seeking to liberalize the economy in an effort to stimulate growth and attract foreign investment. 2003 saw significant strides forward with the adoption of long-awaited capital market and cooperative insurance laws, a new corporate tax law, the passage of an anti-money laundering and terrorist financing law, and an updated copyright protection law.

Population & Labor

With one of the highest birth rates in the world (3.3-3.5%) and 70% of the population under 30, Saudi Arabia faces serious pressures for job creation. Unemployment is officially estimated at 8.4%, but is more likely around 15% and could run as high as 20%. Saudi women, hired under strict gender segregation requirements, represent only 4-6% of the labor force, primarily in education, health care and banking. Currently, the large majority of workers in the private sector are foreign, numbering 5-6 million with most coming from South Asia, the Philippines, and Africa.



Although the oil sector accounts for more than one third of GDP, it employs less than 2% of the labor force. Thus, in an effort to increase employment opportunities for Saudis, the government has pursued an ambitious program of "Saudization," requiring private companies to increase the share of Saudi employees in their labor force by 5% per year. The Saudization program has encountered problems. Some companies have merely added Saudis rather than replace expatriate labor. Efforts by the government to convert entire job categories virtually overnight to Saudi-only fields, for example sales positions in travel agencies and gold markets as well as other retail businesses, resulted in business disruptions because sufficient numbers of trained Saudis were unavailable. In some sectors such as banking and petrochemicals, Saudization rates exceed 90%. Replacing expatriates with Saudis alone cannot solve Saudi Arabia's employment pressures. The government needs to create conditions that will foster a robust, growing private sector with expanding employment needs and an educated Saudi workforce equipped with 21st century job skills, including technical and foreign language capabilities. Government efforts to modernize the education system by providing more technical and vocational training opportunities are encouraging and should be accelerated.

Banking and Securities

The Saudi banking sector remains one of the strongest and most profitable in the region. With high liquidity and oil-sector driven profits, the banking sector performed as well as the rest of the Saudi economy in 2003, recording asset growth and profit gains. Currently there are 11 banks operating in Saudi Arabia, ten majority-owned Saudi banks and one GCC bank, Gulf Investment Bank (Bahrain). Three other GCC-based banks, Emirates Bank International (UAE), National Bank of Bahrain, and National Bank of Kuwait, hold licenses to operate in the Kingdom, but have not yet opened their doors. In 2003, the Saudi Arabian Monetary Agency (SAMA) granted Deutsche Bank the first foreign (non-GCC) banking license in 20 years. HSBC and other international financial houses have also applied for banking licenses. SAMA seems receptive to new entrants, which should deepen the pool of prospective project financing. In 2003, the government requested and received for the first time a sovereign rating ("A" for long-term foreign currency risk and "A+" for local currency risk) from international rating agency Standard & Poor's. There is expectation that in 2004 the government may sell its 50% share of the National Commercial Bank (NCB), held since 1999, if the NCB can successfully list on the Saudi stock market in 2004.

Saudi Arabia does not have an Islamic banking law in place and there is no officially licensed Islamic bank operating in the Kingdom. However, to meet consumer demand for such services, Saudi commercial banks all offer some form of Islamic banking products. As an indication of their popularity, these products account for approximately 17% of all assets in the Saudi banking system. Competition among banks focusing on the Islamic banking services market will increase in 2004 with the expected IPO of a new bank formed from eight exchange and remittance houses. The as yet unnamed bank will have a retail banking focus and will operate under Islamic guidelines, but will receive a conventional banking license from SAMA.

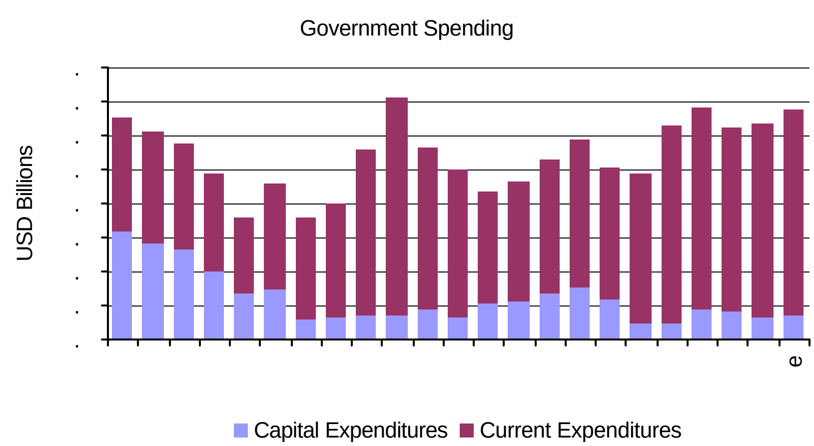
The Saudi stock market registered gains for a fifth year in a row, doubling overall market capitalization in 2003. A good portion of the oil profits in the Saudi economy found its way into the Saudi stock market, driving up the Tadawul All Share Index (TASI) by 76%. The gains are even more remarkable considering the Saudi economy weathered the war in Iraq, a slow recovery in western economies, and fears of a post-war oil price crash in 2003. The market's positive performance in the first quarter of 2004 may be due more to a shortage of investment options in a cash-rich economy than expectations about the long-term earning potential of listed firms. The Saudi exchange is very thin, with only 71 companies listed. Majority state-owned enterprises Saudi Telecom and Saudi Electric were among the highest performing stocks in 2003. These firms are also the sole representatives of their respective sectors. The Saudi stock market remains closed to direct foreign participation except for GCC country citizens. Foreigners can invest in sector-specific mutual funds offered by Saudi banks.

The new Capital Markets Law, passed in 2003, allows for brokerages, asset managers, and other non-bank financial intermediaries to operate in the Kingdom. The law creates a market oversight body, the Capital Market Authority, and an independent, publicly held stock exchange. Up to now, brokerage and financial management services were available only through commercial banks. New financial firms established under the new law will drive an increase in corporate and consumer finance activity. The IPO market will likely develop slowly as commercial banks and other underwriters gear up to help private Saudi firms go public under the law's streamlined registration procedures.

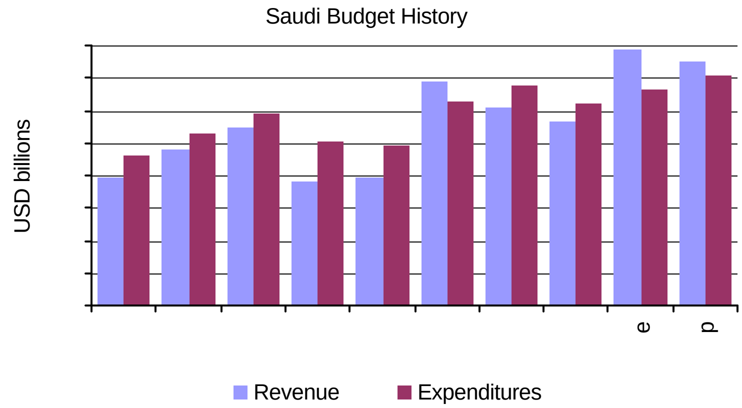
The Co-operative Insurance Companies Control Law, adopted in 2003, establishes capitalization requirements for insurers, sets up an insurance industry regulatory body, offers protections for the insured and investors, and creates a grievances board for dispute resolution. Local capital markets are likely to benefit since the new law requires insurance providers to register locally as joint stock companies. As of May 2004, insurance remains on the "negative list" of sectors in which foreign participation is prohibited, but it is anticipated that the insurance sector will be taken off the negative list and direct foreign investment will be permitted in 2004.

Budget

The Saudi budget process is opaque. Little is known about the method of planning and the actual breakdown of anticipated revenues and expenditures. Some items are off budget. Most important, the oil price forecast from which the government derives nearly 75% of its revenues is not officially released. The government appears to favor conservative estimates of oil revenue for planning purposes. The 2003 budget was apparently planned on the basis of $17.50 per barrel at production rates of around 8 million barrels per day (mbpd). Actual production exceeded 9.5 mbpd at prices of nearly $27 per barrel. High oil prices translate into surpluses or smaller deficits. Every $1 increase in oil prices can result in $2–2.5 billion in additional revenues. Typically, current expenditures (wages, debt service, maintenance and supplies) make up the bulk of the budget while capital expenditures for infrastructure investment are a declining share.



In 2003, the government recorded revenues of $79 billion against expenditures of $67 billion. As cash from the oil sector rolled in throughout the year, the government used newfound liquidity to recharge foreign asset holdings (up $17 billion at year's end). The government also used an estimated $5 billion of the $12 billion surplus to pay down domestic debt, reducing it to 80% of GDP. Saudi Arabia has virtually no foreign debt and budget shortfalls are financed domestically. Most public sector debt (about 80%) is financed by the two major pension funds, which currently have large cash positions given the low retiree-to-active-worker ratio. Oil revenues aside, the Finance Ministry is hard pressed to find additional revenue streams as Saudi citizens pay no income tax and customs duties were reduced significantly in 2001 in preparation for a GCC customs union. One possible new source is privatization of state-owned enterprises. In 2003, the government generated substantial revenues from the 30% sale of its stake in the Saudi Telecommunications Corporation.



For 2004, the Saudi government projects budget revenues of $53 billion against expenditures of $61 billion, resulting in a modest $8 billion deficit. The 2004 budget appears to be based on a conservative oil price of $20.5 p/b at a volume of 7.6 million b/d. Given continued high oil prices into 2004, actual revenues are likely to be much higher and the projected deficit could change to a surplus. The projected 10% spending increase over 2003 budgeted amounts is mildly expansionary, with the largest increases in education, health, labor and welfare.

Saudi Arabia's defense and national security budget line item in the Saudi Arabian Monetary Agency's annual report includes spending by the Ministry of Defense and Aviation and the Ministry of the Interior and other agencies. The share of budget going for defense and security declined from 42% of total expenditures in 1999 to 34% in 2003. A significant portion of this line item goes to fund police, internal security, customs and immigration. Defense and security expenditures remain the largest sectoral allocation of budget spending, even though procurement of goods and services has declined over the years as spending has shifted to social services. However, increased government spending on domestic security is expected in the aftermath terrorist attacks in the Kingdom in 2003 and 2004.

WTO Accession

Accession to the World Trade Organization (WTO) is a fundamental component of any long-term Saudi economic reform program. All applicants to the WTO must bring their trade laws and practices into conformity with WTO obligations and negotiate acceptable schedules of market access commitments in goods, services and agriculture. Membership in the WTO can bring a wide range of benefits to Saudi Arabia. Among other things, accession will require Saudi Arabia to remove protectionist barriers, place ceilings on tariffs, further open key services sectors to foreign participation and improve intellectual property rights protection. These changes will result in an open, transparent and rules-based trade regime. The resulting enhanced competition should introduce new efficiencies and growth to the economy, which will attract capital from both foreign and domestic investors. This approach is fully in line with Crown Prince Abdullah's strong endorsement of economic reform and the creation of a more attractive investment climate in Saudi Arabia.

The government reinvigorated its drive for WTO membership in 2003, with the result that by the end of the first quarter of 2004, Saudi Arabia had signed bilateral market access agreements with virtually all interested trading partners except the United States. Within a seven month period (from October 2003-April 2004), the WTO Working Party on the Accession of Saudi Arabia met three times to review Saudi Arabia's progress in bringing its trade and investment regime in line with WTO obligations and concluding bilateral agreements with trading partners. Saudi and U.S. trade negotiators are closely engaged in ongoing discussions. The United States views Saudi Arabia's accession to the WTO as a positive achievement for Saudi Arabia and for the global economy.

Foreign Direct Investment

Saudi Arabia's Foreign Direct Investment Law, adopted in 2000, removed the requirement that foreign investors take local partners, allowed foreigners to own property, sponsor their foreign employees, and invest in any sector not included in the so-called "negative list." (The sectors currently closed to foreign investment include three manufacturing categories and 16 services industries. The list is available at www.sagia.gov.sa. Several prohibited sectors, such as insurance and telecommunications, should officially open to foreign investors this year.)

In 2003-4, the government took significant, long-awaited steps to lower the corporate tax rate on foreign investors to a flat 20% and institute a legal framework for banking and insurance sectors that will make the investment environment more attractive to foreign capital. However, major impediments to foreign investment remain, including lack of a transparent, comprehensive legal framework for settling commercial disputes; convenient access to multiple entry-exit visas without the need for a Saudi sponsor; national treatment for corporate taxes; access to a skilled, motivated labor force; modern infrastructure, including state-of-the-art telecommunications; and protection of intellectual property that meets international standards.

The Saudi Arabian General Investment Authority (SAGIA), established by the new FDI law to promote and facilitate foreign investment, is an independent agency reporting to the Supreme Economic Council, the country's top economic policy-making body. With offices in Riyadh, Jeddah, and Dammam, SAGIA was designed as a "one stop shop" to eliminate the need for foreign businesses to deal with multiple Saudi ministries to obtain the necessary stamps and approvals. Through March 2004, SAGIA had issued 2,220 licenses for projects worth a total of $15 billion. Of these, 1,500 projects valued at $10 billion are 100-percent foreign owned. Unfortunately, to date SAGIA does not appear to have lived up to the high expectations engendered by its creation. Investors complain that impediments remain, many outside SAGIA's capability to correct. Moreover, it is investment inflows, not licenses, which are the true measure of whether Saudi Arabia has succeeded in attracting more foreign direct investment.

Saudi Arabia's net foreign investment inflows on a relative basis have lagged behind those of many other developing nations. Although there is a substantial lag in the data, any positive effect the new FDI law and creation of SAGIA may be having on investment inflows is not evident in the data.

Foreign Direct Investment in Saudi Arabia
($ Millions)

Year	Net Inflows	Accumulated Stock
1995	-1,877	41,164
1996	-1,129	40,035
1997	3044	43,079
1998	4289	47,368
1999	-780	46,588
2000	-1884	44,704
2001	20	44,724
2002	-350	44,374

The Private Sector and Privatization

Large state firms dominate the Saudi economy, including the giant oil firm Saudi ARAMCO, Saudi Arabian Basic Industries Corporation (SABIC), Saudi Telecommunications Company (STC), the Saudi Electricity Company (SEC) and the Saline Water Conversion Corporation (SWCC). Prior to the 1970s oil boom, parts or all of many of these firms, including ARAMCO, were in private hands. In recent decades, the private sector has accounted for roughly 40% of GDP.

Privatization could prove an extremely useful tool for the government to restructure the economy, augment government revenues and allow for the retirement of public debt, and encourage the inflow of private (both foreign and Saudi) capital to help meet the infrastructure investment needs of telecommunications, water, power, and transportation. Dismantling state monopolies would also create more competition and efficiency, lead to the introduction of new management and technology, and reduce pressure for subsidies.

Although the government approved a list of activities and services targeted for privatization in November 2002, progress has been slow. Some private firms have been allowed roles in management of seaports and airports and in provision of some health and education services. Private health clinics and hospitals are a growth area, given high rates of diabetes and smoking in the Saudi population. In January 2003, the government completed the long-awaited sale of 30% the Saudi Telecommunications Company (STC), garnering over $ 4 billion, which was used to pay down domestic debt.

The Saudi government is starting to open the telecommunications sector to competition. In 2003, the Saudi Communications and Information Technology Commission (CITC) licensed several commercial entities to distribute VSAT technology. In 2004, the CITC began a licensing process for a second GSM mobile phone operator that will compete directly with Al-Jawal, the mobile phone network provider of the majority government-owned STC. Saudi Arabia will realize much greater benefits from telecom liberalization when a third competitive license is offered through a technology-neutral tender, which would allow service providers greater flexibility to respond to the needs of the market and ensure users access to state-of-the-art technology.

There is a pressing need for significantly greater investment in power generation and water desalination to meet the demands of Saudi Arabia's burgeoning population. Industry studies estimate that capital investment on the order of $117 billion in power and $80 billion in water are essential before 2020. Most of this money will need to come from the private sector, including foreign investors. The Saudi government appears to be moving towards a significant restructuring of the country's power sector, including moves towards unbundling of power generation, transmission, and distribution, plus an increase in private sector involvement. In November 2001, the government established an independent Electricity Regulatory Authority and in July 2002, set out a framework for private investor involvement in developing independent water and power projects (IWPPs). Hoping to attract private investment for up to 60% equity in IWPP projects, the government is considering providing a guarantee that local Saudi companies would purchase the electricity and water produced. This is important because low prices (subsidized consumption) for power and water in particular have tended to discourage private interest in these sectors. The Government has plans to construct 22 new water plants, including six with daily capacities between 350-450,000 cubic meters. The Water and Electricity Company, a joint venture of SWCC and the SEC, will act as offtakers of the power and water from the IWPPs, under a 20-year power and water purchase agreement.

GCC Economic Integration

In January 2003, the GCC inaugurated a customs union with a common external tariff of 5% for most goods and an internal duty-free market. Member countries have not finalized some of the practical details, such as the mechanism for revenue distribution after tariffs are collected at the first GCC point of entry. Nonetheless, the GCC is moving forward with its plan for greater economic integration and with ambitious plans to establish a monetary union in 2005, a common market in 2007, and a unified currency based on the dollar by 2010. The GCC is also opening up some GCC activities to Yemeni participation.

Saudi Foreign Aid

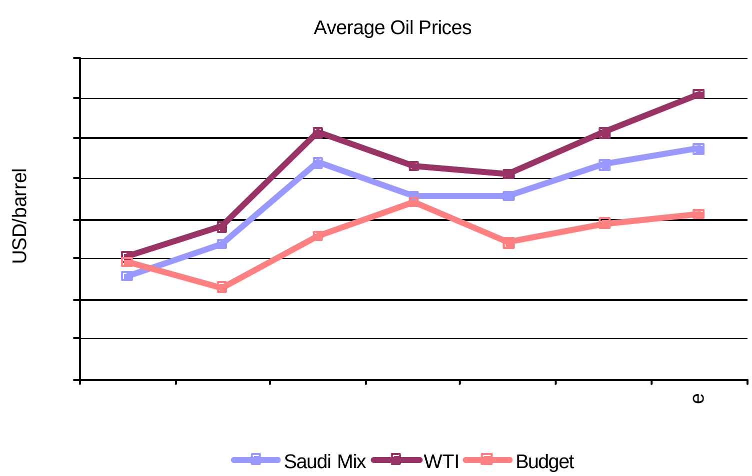
Historically, Saudi Arabia has been one of the world's largest foreign aid donor countries, but in recent years has faced increasing demands to fund domestic security, infrastructure development and social programs at home. The Kingdom manages contributions to international aid projects through the Saudi Fund for Development (SFD) and the Ministry of Finance. The SFD handles long-term development programs and the Ministry of Finance handles grants and immediate assistance needs. In recent years, aid has shifted from direct grants toward concessional loans and in-kind assistance. In an effort to promote trade-based aid, the government established the Saudi Export Program (SEP) in 2001 to help diversify the economy and increase Saudi exports. The SEP is housed within the SFD and operates like the US Export Import Bank by securing financing and insurance services for companies exporting products with at least 25% Saudi content.

In November 2002, the government pledged a total of $230 million ($200 million in loans and $30 million grants) to the Afghan transitional authority. In October 2003, Saudi Arabia pledged $1 billion in for Iraq reconstruction; $500 million in soft loans and $500 million in export guarantees. During 1975-2002, the SFD funded $6.1 billion worth of projects in 64 countries, mostly in Asia and Africa.

- OIL –

Saudi Arabia (including half of the Saudi-Kuwaiti "Neutral Zone") contains 264 billion barrels of proven oil reserves, more than 25% of the world total, and up to 1 trillion barrels of ultimately recoverable oil. Saudi Arabia is the world's leading oil exporter and maintains production capacity of around 10.0-10.5 mbpd. Although Saudi Arabia has around 80 oil and gas fields and over 1,000 wells, more than half of its oil reserves are contained in only eight fields, including Ghawar (the world's largest onshore field, with estimated reserves of 70 billion barrels) and Safaniya (the world's largest offshore field, with estimated reserves of 19 billion barrels). Saudi Arabia maintains an excess production capacity of approximately two million barrels per day, a vital contribution to oil market stability in the event of unanticipated supply disruptions. Saudi oil policy makers remain committed to being reliable suppliers and have renounced any interest in using an oil embargo as a "weapon" to influence U.S. foreign policy.

OPEC Policy



Saudi Arabia is the most influential member of the Organization of Petroleum Exporting States (OPEC). OPEC's target price for a basket of various crude oils is $22-$28. According to this price band mechanism, if OPEC oil sells above $28 for 20 consecutive trading days, OPEC members should produce additional oil to moderate prices. The OPEC basket has been trading above $28 since December 2003. Instead of producing additional oil to calm the markets, in February 2004, OPEC voted to cut production quotas by 4%, from 25.4 mbpd to 23.5 mbpd, effective April 1, 2004. At its March 2004 meeting, despite a price well above $28, OPEC ministers allowed the production quota reductions to come into effect. This suggests the organization is prepared to defend a price above the official OPEC band. In early May 2004, the OPEC basket was trading well above $30.

Saudi Upstream: Natural Gas and Petrochemicals

In 1998, His Royal Highness Crown Prince Abdullah proposed opening Saudi Arabia's upstream sector to foreign investors for natural gas exploration. His proposal developed into a $25 billion concept that would have offered foreign firms three sets of upstream natural gas blocks for exploration and development, coupled with building and operating petrochemical plants and power and water cogeneration facilities fueled by the anticipated natural gas finds. The negotiations on the grand integrated upstream-midstream-downstream initiative ultimately broke down. Immediately following that failure, in July 2003, the Ministry of Petroleum announced an auction to open up the Ghawar area to foreign investors for non-associated natural gas exploration. In January 2004, six companies competed in the auction for the three offered blocks. Russia's Lukoil, China's Sinopec, and a joint bid by Italy's Eni and Spain's Repsol, each won a block and signed 40-year exploration and production contracts with the Saudi Minister of Petroleum in March 2004. The deals signed in 2003 and 2004 mark the first time since the total nationalization of ARAMCO in 1980 that foreign oil companies have been permitted to explore in Saudi Arabia. Foreign investment in the full upstream hydrocarbon sector will be vital in the coming decades if Saudi Arabia hopes to expand production capacity to meet expected growth in international demand.

Saudi Arabia's proven natural gas reserves are estimated at 224.7 trillion cubic feet (Tcf), ranking fourth in the world. Around two-thirds of Saudi Arabia's currently proven natural gas reserves consist of associated gas. The Ghawar oil field alone accounts for one-third of the country's total natural gas reserves. With domestic hydrocarbon demand growing rapidly for power generation, petrochemicals, and desalination, increasing natural gas production and replacing oil consumption with natural gas are priorities for the Saudi government. Using natural gas instead of oil domestically will free up additional crude oil for export since OPEC quotas are on production, not exports. Overall, Saudi Arabia aims to triple natural gas output to 15 Bcf/d by 2009. To date, Saudi Arabia has not expressed great interest in exporting liquefied natural gas due to doubts regarding economic viability. Domestic demand is driving a $4.5 billion expansion of Saudi Arabia's Master Gas System (MGS), which was completed in 1984. The MGS feeds gas to the industrial cities of Yanbu on the Red Sea and Jubail in the Eastern Province. Prior to the MGS, all of Saudi Arabia's natural gas output was flared.

Saudi Arabia has ambitious plans for expanding petrochemical production using natural gas as a feedstock. State-owned SABIC, the Middle East's largest non-oil industrial company, accounts for around 10% of world petrochemical production and is expected to become one of the world's top five ethylene producers by 2005. In February 2001, SABIC completed a $1 billion expansion at the Yanbu petrochemical facility, making it the largest polyethylene plant in the world. In April 2003, ARAMCO awarded a turnkey contract to Snamprogetti to build two new units at the complex. In January 2002, SABIC agreed to a $1.15 billion loan to fund a new petrochemicals plant in the eastern Saudi Arabian industrial city of Jubail. The complex is scheduled to come online in 2004, and to produce 1 million tons per year of ethylene, plus olefins, polyethylene, and glycol ethylene. It is uncertain at the present time whether the Saudi government will sell off more of its 70% stake in SABIC in the near future. SABIC receives ethane gas from Saudi ARAMCO at 75 cents per million Btu, far below international prices.

International Energy Forum

In 2000, Crown Prince Abdullah proposed that a permanent secretariat for the International Energy Forum (IEF – also known as The Consumer-Producer Dialogue) be established in Riyadh. The IEF is a voluntary and informal group of states, including the United States of America, representing both energy exporters and importers, dedicated to improving energy policy cooperation, data-sharing, and market transparency. In 2003, Norwegian diplomat Arne Walther was elected the first Secretary-General of the IEF and the Secretariat was established in Riyadh in late 2003.

- FINANCE & CURRENT ACCOUNT -

Saudi Foreign Assets and Capital Outflows

Saudis have an estimated $650-700 billion in overseas assets, three times larger than Saudi Arabia's GDP. Attracting some of these funds back into the country could improve economic growth rates and generate jobs. Unfortunately, state monopolies, a relatively shallow stock market with comparatively few listed companies, and limited privatization opportunities leave Saudi investors with few options (apart from construction and real estate) for domestic investment. The new capital market and insurance regulations and the opening of services sectors (such as telecommunications and insurance) to competition as a result of WTO membership should, in the long run, stimulate economic activity and widen opportunities for both Saudi and foreign investors.

Inflation and Currency

As a result of generally prudent monetary policy, Saudi Arabia enjoys low inflation and interest rates close to U.S. levels (historically between 30 and 50 basis points higher than U.S. rates). Depreciation of the U.S. dollar against major currencies in 2003-4 is putting some inflationary pressures on the Saudi economy as consumers pay more for Euro-priced goods, however. Interest rates are allowed to float freely, capital flows freely across borders and the U.S. dollar-Saudi riyal exchange rate remains stable.

Current Account

In 2003, the $25 billion current account surplus was largely the result of high oil sector profits. If oil prices continue at their current high levels, the 2004 current account balance could be substantial.

Remittances

Remittances from 5-6 million foreign workers are a perennial drain on Saudi Arabia's current account. In 2003, these transfers abroad totaled $16 billion. Allowing foreign workers to own their own houses, and to invest in companies they have either come to know or work for in Saudi Arabia, could provide the means to keep significantly more capital in the local market and boost economic activity. In August 2000, the Government issued regulations permitting foreigners to own non-commercial real estate. At present, however, a system is not in place to make this a reality.

Net outflows of capital due to tourism outside the country amount to about $5-6 billion annually. The tourism council is trying to encourage Saudi residents to spend more vacation time in Saudi Arabia. These efforts, if successful, should help reduce the net outflow of capital connected with tourism.

Exports and Imports

The U.S. and Saudi Arabia have a very strong trading relationship, but one that is subject to great swings on both the import and export sides due to volatile oil prices. Saudi Arabia remains the largest Arab market in the Middle East and North Africa for U.S.-produced goods. The chart below provides U.S. (civilian and military) export and import trade with countries in the region.

US Exports to Middle East
($ Millions)

Rank	Country	2001	2002	2003
1	Israel	7,475	7,027	6,878
2	Saudi Arabia	5,958	4,781	4,596
3	UAE	2,638	3,593	3,510
4	Egypt	3,565	2,869	2,660
5	Kuwait	903	1,015	1,509
6	Bahrain	433	420	509
7	Jordan	339	404	492
8	Qatar	336	314	408
9	Oman	306	356	323
10	Iraq	46	32	316

US Imports from Middle East
($ Millions)

Rank	Country	2001	2002	2003
1	Saudi Arabia	13,272	13,150	18,069
2	Israel	11,959	12,416	12,770
3	Iraq	5,820	3,548	4,574
4	Kuwait	1,991	1,940	2,277
5	Egypt	882	1,356	1,144
6	UAE	1,194	923	1,129
7	Oman	420	401	695
8	Jordan	229	412	673
9	Bahrain	424	395	378
10	Qatar	502	485	331

- 2004 OUTLOOK -

The Saudi economy should turn in another solid performance in 2004 if current oil prices and production levels continue. For 2004, we estimate 0.75% nominal GDP growth, a $1.8 billion budget surplus, a $10 billion current account surplus, no change in the pegged USD-Saudi Riyal exchange rate, interest rates at an average 50 basis points above equivalent rates in the United States, and moderate 1.0% inflation. Oil sector GDP growth is forecast to be down 4% in nominal terms; the non-oil private sector is expected to post a 4.5% gain; and the government sector is expected to increase 2.5%. Given this scenario, government revenues should be sufficient to cover planned expenditures for education, health and public security.

Saudi Arabia's economic challenges can be met through making the best use of the tools, both human and financial, at hand. Adoption of important economic reform legislation in 2003, excellent prospects for WTO membership in 2004, efforts underway to revamp the education system to meet the needs of the modern workplace, and strong economic performance in 2003 and 2004 all have created a strong foundation for continued progress. Addressing Saudi Arabia's structural challenges through further economic reforms will do much to unleash market forces, leading to greater growth, more jobs and increased economic activity. To the extent Saudi Arabia puts more of its natural strengths to work, its economic future will be brighter.

Note: One of the principal challenges for an analyst of the Saudi economy is developing reliable and consistent data. All too often there are little or no data available for key indicators or if multiple sources exist they are often contradictory. The information presented above represents our best efforts to provide solid numbers, but we cannot guarantee their accuracy.

Sources:
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